Transcript for ESOP Update - June 24, 2010 (2:00PM Session)

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Moderator: Welcome to the ESOP Update Phone Forum. At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session. Instructions will be given at that time. As a reminder, today's conference is being recorded. I would now like to turn the conference over to your host, Mr. John Schmidt. Please go ahead.

J. Schmidt: Thanks, Kim, and hello, everyone. As Kim indicated, I'm John Schmidt. I'm the acting director of customer education outreach for employee plans atthe IRS. Thank you for dialing into our phone forum entitled ESOP Update. Please be advised, the following program, including questions and answers, will be recorded and maintained in accordance with federal record keeping laws. This recording is a work of the U.S. government and is in the public domain. A transcript and/or audio recording of this program may be made publicly available on our Web site www.irs.gov.

Today we will be hearing from Robert Gertner, Tax Law Specialist in Employee Plans, Rulings & Agreements with the Internal Revenue Service. Robert has been working on ESOP issues in the guidance branch for the past several years. We will also be hearing from Clare Diefenbach, Tax Law Specialist in Employee Plans, Rulings & Agreements. Her work focuses primarily on ESOPs and includes drafting guidance and responding to ruling requests.

At the end of Robert and Clare's presentations, there will be a question and answer session. If you want during their presentation, you may e-mail any questions you have to ep.phoneforum@irs.gov with your phone number, and one of the speakers will respond to your question. For those of you that don't have your questions answered actually during the phone forum, please note that Robert or Clare will respond to you via the phone, so don't forget to include a number where you can be reached.

We will be e-mailing a certificate of completion to everyone who registered for this session and who attends the full session. Enrolled agents are entitled to continuing professional education credit for this session. For tax professions other than enrolled agents, consult with your licensing organization to see if it will provide continuing professional education credits for this session.

For those of you who might not be aware, the IRS has lots of retirement plan information on our Web site at www.irs.gov/ep. You can also get there by getting to the main IRS Web page and clicking on the retirement plans community tab at the top. In addition, once you're there, you may want to subscribe to one of our free electronic newsletters. The link for newsletters is in the left hand navigation bar. We have two newsletters, the *Retirement News for Employers*, which is directed towards employers sponsoring a retirement plan, and the *Employee Plans News*, which is directed towards professionals who practice in the retirement arena. Please check out our Web page and subscribe to our newsletters. Without further ado, here is Robert Gertner.

R. Gertner: Good afternoon. Good morning. I'm Robert Gertner. As my bio states, I've been working in the employee plan division for over 30 years. I spent many years working on private letter rulings (PLR), mostly as a reviewer, and I still do some private letter rulings. In the past, I found myself working so many ESOP private letter ruling requests that I transitioned into employee plans guidance where my focus is on working ESOPs. In guidance, as you know, we work in
regulations, notices, and the like. Clare is of much newer vintage, but she has jumped feet first into this ESOP guidance work.

It is hard to think of an area potentially larger than one entitled ESOP update. With regulations over 30 years old, many of them obsolete by later enactment of ESOP law, and when you're talking about ESOPs, you're basically talking about all the law that we have right now for (that is, all the law enacted in the past 30 years). All of that has been enacted since the regulations have been in place, and that was back in the '70s. Without this formal guidance, the ESOP community has engaged in a very active best practices program, and I really appreciate that. I do get a tremendous amount of feedback from the practitioner community, and going over what they think is practices has been extremely helpful in forming my own opinion about these matters.

I believe, and others share that belief with me here that the time is right for us to step up to the plate, and we have officially decided to think about it, which is actually more than it sounds. We have been going through the old regulations. There's certainly much regulatory housekeeping at the very least that needs to be done, as well as filling in many of the guidance gaps. We've had a series of discussions with a broad range of ESOP practitioners, and we are beginning coordination with the Department of Labor.

At some point we will decide whether to go forward or not. And if we decide to go forward, we could decide to go forward with a comprehensive set of regulations or perhaps a rifle approach choosing several areas to address. It could be revenue rulings or notices. We have not yet decided to move forward with this project.

In the absence of such a project, this ESOP update will consist of a number of narrow gauge topics. The first is the 401(a)(35) final regulations, which I will get to in a second. The others are topics of and for our determinations branch. Our determination letter program, in particular, our ESOP determination letter program must go on with, or

without regulations. And there were a number of issues blocking the letters, ESOP letter request from being processed.

As a result, our colleagues over at our determination branch made a series of technical assistance requests from employee plans guidance. That's us. That's Clare, and that's myself. And we were asked to give technical help in order to allow the ESOP program to get moving.

Our responses were all provided strictly in the context of what is and what is not acceptable plan language. What we attempted to do was to answer the questions and give what we believed were the appropriate standards and attempt to provide some analytical framework that could be used to determine acceptable or not acceptable plan language. If the devil is in the details, here the devil is in the plan language and the determination as to what actual language is acceptable. All this is within the responsibility of the determinations branch.

As most of you know, the determinations branch have a number of people who are dedicated to ESOP work. They are backed up by their quality assurance branch. They have the very tough task of applying the analysis, the attempt to provide to actual plan language.

I always thought that the easy part is essentially the theoretical part, what I do and what Clare does. What is much harder is coming up with acceptable plan language. The way that has worked out is really sort of an active dialogue, I guess, to say the least, between ESOP practitioners and the ESOP cadre backed up by the technical assurance, quality assurance determinations branch.

This is a very difficult and at times lively sort of process. But that's the way things are done. Just to reiterate, coming up with what is acceptable plan language or what is not acceptable plan language is within the jurisdiction of our determinations branch. Should they need, and they show they're certainly capable of doing it, they could ask us, and we're more than happy to provide that help.

This whole process in terms of getting appropriate plan language makes the 401(a)(35) final regs easy and straightforward, so I'll get right on to it. As I guess you know, the 401(a)(35) was enacted as part of the Pension Protection Act of '06, which obviously Section 401(a) was amended to add Section 401(a)(35). In addition, 401(a)(28)(B) was also amended to provide that for plans that fall within a subject of 401(a)(35), at least for these plans, they are not subject to 401(a)(28)(B). Then, of course, those plans that are not subject to 401(a)(35), they remain subject to the diversification rules of 401(a)(28)(B).

The basic definition for 401(a)(35) in terms of what plans it covers is the term "applicable defined contribution plan," and it's defined within the statute itself. The first step in determining whether you have such a plan is to determine whether you hold publicly traded stocks. Now publicly traded stock is defined in 401(a)(35) as stock,

which is readily tradable on an established securities market. The meaning of that phrase was always one of my favorite issues when I was working in private letter ruling … the '90s. At the time, what we basically did, we borrowed the definition of publicly traded from the 4975 regs, and this really highlights the difficulty we have here because obviously that language predates readily tradable. It is under 4975, publicly traded. And as I said, readily tradable is obviously used in 401(a)(35). It's also used in 409(h) and (l), and obviously the question arose in those contexts.

Now we issued a number of private letter rulings, but to be very clear, and just to reiterate this several times, private letter rulings have no precedential value. They only have value to those to whom the private letter ruling is addressed to. In other words, you could say they're worthless and valueless to anyone else.

Both chief counsel and treasury always like to make a strong point that private letter rulings are not guidance. They do not control guidance, and those involved in guidance are more than happy to take a position that doesn't take advantage of any of our private letter ruling request positions. But anyway, putting that aside, we did indeed, at the time, make the choice that we were going to use publicly traded and then apply the definition. The definition of publicly traded is very straightforward. It basically says if you are on the New York Stock Exchange or you're traded on NASDAQ, then indeed you are publicly traded. We say, okay, then you're readily traded.

In the 401(a)(35) statute, and in the regs, we go ahead and actually clarify and expand that definition of readily tradable. But keep in mind, this is readily tradable for purposes of 401(a)(35) and not necessarily for any other purpose. In any case we, for the most part, adopted the old 4975 publicly traded definition, and we added – one thing we did add foreign securities that are covered by the SEC ready market rule. A shorthand version of that rule is whether you're listed on the FTSE all world index.

This is a bright line rule, and basically, and here it does repeat our old position. It basically says, if you are not traded on either of the two, and not on the FTSE old world index, let's say you are traded on the OTCBB or the electronic pink sheets or years ago on the pink sheets themselves then that stock would not be considered to be readily tradable.

Now, as I said, the bright line rules basically allows us, allows an exam agent to go out and make the determination as to whether … make it in a relatively straightforward fashion whether the stock is readily tradable or not. Obviously, as many of you know, it is a very important decision. It determines whether a put option is required or whether you have qualifying employer securities. For example, if you have readily tradable stock, that is the stock you must use. You don't drop down to 409(l)(2).

Well, we have this bright line rule that allows an EP exam agent to check up on that determination very easily. It does not relate to the frequency of trades. It doesn't go to the volume of shares traded. We really thought that that would be, first of all, a moving

target. Plans could be moving in or out of that particular readily tradable definition. We did not think it was workable.

We certainly understand and appreciate the fact that you might very well theoretically find shares that are, one could argue, more marketable, have more trades on the OTCBB than other shares traded on NASDAQ. We understand that, but we really felt we had no other option but to apply this very straightforward bright line test. And it's out there. You all can see it, and so there's no mystery involved.

Let me get a little ahead of myself because … just to stick for a minute or two on this readily tradable issue. In the proposed regs, we make the statement that we thought that there was a presumption that the definition of readily tradable with regards to 401(a)(35) should be the same definition of readily tradable with regards to interrelated provisions, ESOP provisions. And I think that we have a compelling case for that. We think it would odd to define readily tradable different for 409(h), which gives or does not give put option rights depending on whether you're readily tradable, than for 401(a)(35), which gives stock, which is readily tradable and does not have these put option rights, this extra diversification right. It just seems ill fitting at best that somehow we went down a path where different definitions of readily tradable will be applied to different ESOP sections.

If we were to take that stand saying apply to all, we would do that, I would think, in the form of a notice. We, of course, have been thinking about this. And it's quite possible that we might have a notice coming out on this in the very near future, but let's go back to 401(a)(35).

As I was saying, an issue is whether you have to hold readily tradable stock. Now there are some times you can be holding, a plan can be holding readily tradable stock, and we don't count it as such for 401(a)(35), and … when they're readily tradable securities, they are held in these broad investment funds. These investment funds would have stated investment objectives, and they would be independent of the employer. We added essentially a bad harbor rule saying that if 10% or more of the investment fund is invested in this employer's security, then indeed it has to be counted as publicly traded for that particular employer. On the other hand, a plan that holds employer securities, which are not readily tradable, is treated as holding readily tradable securities and any member of its controlled group does indeed, has indeed issued readily tradable stock.

We were talking about an applicable defined contribution plan that has readily tradable stock. There is a very big ESOP exception here for ESOPs, which hold no amounts attributable to amounts from 401(k), amounts subject to 401(m), and is a separate plan from any other DC or DB plan of the employer, and it must meet both requirements to be excepted from 401(a)(35). Stand-alone ESOPs remain subject to 401(a)(28)(B), so for many ESOPs out there, it's business as usual.

These new diversification requirements, and I'll get to that in a second, apply immediately to employee contributions and elective deferrals. However, with regard to

non-elective contributions, the requirements apply after the participant completes three years of service. So now the question is, what are these new and expanded 401(a)(35) diversification requirements. Under 401(a)(35) the plan must provide for a participant to have the right to divest his account of employer security at least once every three months, and must also offer three other investment elections, and each one of these investment elections must be materially diversified. There are some DOL regs that we borrowed to make that determination in the regs.

What are the rules with regard to an employer stock fund, for example? The rule is that a plan may not place conditions or restrictions, direct or indirect, on the ability of a participant to divest his account of employer securities that is not placed on any other investment. In other words, the divestment rights, the ability to divest out of an employer security must be as good as the most wide ranging divestment rights in any other plan investment.

Now, of course, as with everything here, there are a number of exceptions. For example, and this is a statutory exception, and we do put a little gloss on it in the regs, but basically additional restrictions can be placed on divestment of employer securities if it's reasonable to do so to be in accordance with securities law, and I guess most of you are familiar with certain situations that arise in terms of people who are not, should not, are not allowed to purchase employer securities.

Another exception, let's say for example the plan has a particular non-employer security investment fund, which allows for day trading. One would say, well, that means the plan must allow for day trading of employer securities. We thought that it would be a good idea to allow employers to put a limitation on day trading with regard to their own security and, indeed, we allow for a seven-day period between trades.

There are a number of investments, non-employer security investments, which can also be allowed to be traded with greater frequency than employer securities. For example, there's the Qualified Default Investment Alternative. This is a special type of investment defined by DOL. Under their rules, these investments have total divestment rights for a period of time. A plan can allow for this without affecting the rights an individual has in trading employer securities.

Also, there are stable value funds within a plan; these funds serve a number of purposes. They allow for the plan to remain liquid. Moneys go in and out on a very, very frequent basis in terms of allowing for cash to become available. Those funds can also be traded more frequently than employer security funds.

One area that received tremendous attention when we developed the regs was the rule against imposing a condition on employer stock investment. Generally, a plan provision, which delays the ability to reinvest in employer securities upon divestment of any employer securities, is an unacceptable condition upon divestment. It's basically considered putting a price on people having to divest, making it more difficult, sort of

putting them in the situation where they might very well stay in employer securities, which they might not otherwise do.

Anyway, we said that's not right. However, we did provide for exception if there's an employer stock fund, which is frozen, accepting no contributions. Someone can divest himself of stock in such an employer stock fund. We would not expect the plan to provide for additional investments in the frozen plan because it's frozen.

We have an exception for dividend reinvestment where dividends can go back into a frozen fund, and fund will still be considered frozen. But basically, as we found out, the frozen fund exception did create a problem for a type of plan structure, which we were not familiar with. That is, a plan that provides for contribution of matches to go in as employer securities, but in no other way provide for investment in employer securities. So if you divest yourself of employer securities, that's that. And it's not a frozen fund plan. And it's not a frozen fund because matches are going in.

We did get a tremendous amount of comment on this, in fact, more comments on this than any other part of 401(a)(35). Our response was a transition rule, which allows for the type of plan structure to continue for employer securities acquired in an exempt loan prior to 1/1/07. Now we always thought that 401(a)(35) was a well-written statute, and it was fairly straightforward and pretty logical, which made our job relatively easy. However, feel free to call. I guess there is a means for you to e-mail questions. If you have questions on 401(a)(35), we will respond to them.

The next topics to be covered and that obviously is another slide. We're going to number six. The next topics to be covered are the result of our technical assistance responses that we gave to our determinations branch. Our determinations branch, as I said had a number of questions they had in order to allow them to overcome some problems they were seeing the ESOP area without any guidance, formal guidance out there.

Now our responses were our … responses obviously were directed towards our determinations branch. Keep in mind that they were made without the benefit of any formal type review by Treasury or chief counsel. As I probably said before, these responses are not guidance. They are addressed to our colleagues in the determination branch to help them to determine the acceptability of plan language. And, as I said, and as you all know, they were written without the benefit of regulations and any other type of guidance because, quite honestly, there's very little guidance out there on this.

Should we decide to go ahead with formal guidance? Nothing here will hold us to those….

(Technical difficulty – audio interruption.)

R. Gertner: Kim, are we okay?

Moderator: Yes, please go ahead.

R. Gertner: Did everyone hear everything? Kim? Is everything all right?

Moderator: Yes, everything is okay. Please go ahead.

R. Gertner: Very good. As I was saying, I assume there wasn't any break in that, but anyway, they were written without the benefit of regulations, and as I was saying, if you ever decide to have … guidance, nothing here would really hold us to that.

Now I'm looking at slide number six, and as I said, we wrote this up as a technical assistance request, response to determinations now. These are not out there. They're not on the Web site or otherwise published. They have somewhat, I mean, obviously there are people out there with these technical assistance responses, and a lot of people have them.

It's unfortunate that not everyone has this. It is my hope that these technical assistance responses will be put on our Web site, though I'm not the one to make that decision, and we could just hope for the best.

The only guidance out there for 401(a)(28)(B), is a 23-year-old notice that basically deals with transitional rules and doesn't really help us. The basic statutory definition of qualified participant is any employee who has completed at least ten years of participation under the plan and has obtained age 55. This leaves many questions open. What is a year of participation? Do plan participants need to remain employees to be qualified under 401(a)(28)? The most basic building blocks of 401(a)(28)(B) are open to wide interpretation.

How can appropriate plan language be arrived at in a vacuum? But as you know, with or without regulations, ESOP determination letters need to be processed. The result was the type of help that we've been giving the determinations branch. The positions that we took in this particular response are there solely to determine whether the particular plan language is appropriate or not, and as I keep on saying, that's the job of our determinations branch.

Our approach was to apply a broad definition to who is a qualified participant while recognizing that due to the lack of guidance in this area, there was no way for us to expect that any plan would have adopted this broad definition. With regard to qualified participant, a plan may define "year of participation" as any year in which an individual has assets in an account under the ESOP regardless of whether such individual is employed by the employer at such time, and regardless of whether such individual has completed 1,000 hours of service or such lesser number required under the definition of the years of service under the plan. To repeat again, this is just to allow us to determine what plan language is acceptable or not.

As I said, not surprisingly, there are few if any, plans that had plan language reflecting this broad definition. Generally, we advised our colleagues in the determinations branch

to allow plans to retain their more restrictive language, also allowing plan language relating to 411(a)(28)(B) to be altered, but only to make it less restrictive.

In the next slide, I deal with the mandatory repurchase of S corp. shares, and this is also the subject of a particular technical assistance response. In the PowerPoint, I decided to throw in the automatic put option question. I didn't put in to particularly confuse people. Of course, the automatic put option is really designed for C corps, and basically it's just the regular put option that is applied immediately. There might be some concerns over whether this is actually a stock distribution or not. However, if you basically have a formal process in this, and obviously the participant elects to have this immediate put then you certainly can do it, and essentially there could be situations where the participant just sees the cash. But that's perfectly fine, but you have to be sure to do it all in the formal way.

There is a TAM (Technical Advice Memorandum) out there that does go through this. We use the fact pattern obviously given to us by the particular practitioner whose plan was subject to the exam, which led to the TAM. We're not saying that this is the only way to go, but it does give you an example of an immediate put option.

With regard to the mandatory purchase of the S corp. stock, obviously we're not talking about having an elected put option, so it's in a special category. Basically for S corps and for a couple of other types of plans with stock with trading limitations, things like that, stocks that can only be owned by members of the owner's family, what have you, they're in the special category of shares where the participant of such a plan does not have the right to demand the stock.

Basically if you look at the statute, in the mandatory repurchase, it relates back to 409(h)(1) dealing with the right of a participant to request a put option. But you read that in the context of the fact that the participant does not have the right to demand the stock, so we believe that a mandatory put option, a mandatory repurchase is perfectly fine. As I understand it, that's basically how many of these particular S corp. plans were run.

What I'd like to do now is allow Clare to continue here and talk a little bit about reshuffling and rebalancing.

C. Diefenbach: Thank you, Robert. Our final topic is the fourth technical assistance request, which, as Robert mentioned, dealt with rebalancing and reshuffling provisions. Specifically, the question that our determinations branch posed to us is whether or not an ESOP or stock bonus plan can include a reshuffling provision that allows the trustee or administrator to involuntary exchange employer stock held in participant accounts for cash or other assets allocated to other participant accounts.

Our conclusion was that, yes, plans may provide for reshuffling or rebalancing. There are rules under Section 411(d)(6) that prohibit plans from reducing a participant's accrued benefit by plan amendment. But the regulations under this section specifically state that the right to a particular form of investment such as investment in employer

stock or securities is not a protected benefit under Section 411(d)(6). So the fact that a reshuffling provision might be taking away a participant's employer stock, replacing it with cash or other assets is not by itself a problem, although we do believe that other code provisions impose limitations on what is permitted in reshuffling provisions that I will be talking about.

Before I get to that, on slide ten, I have a couple of definitions. We define both rebalancing and reshuffling as the mandatory transfer of employer securities into and out of participant plan accounts, but rebalancing, when we say rebalancing, we mean a provision that's designed to result in all participant accounts having the same proportion of employer securities, whereas reshuffling is not designed to result in an equal proportion of employer securities in each account.

Moving to slide 11, when our determinations branch submitted their question to us, they raised several concerns with reshuffling provisions. The first is the definite allocation formula requirements of Section 1.401-1(b)(1) of the regulations; second, the diversification requirements of Code Section 401(a)(28)(B); third, discrimination testing for benefits, rights, and features under Section 1.401(a)(4)-4 of the regulations; and finally, the rules relating to asset segregation provisions. As I go over the limitations that are imposed on reshuffling and rebalancing provisions, I'll be discussing each of these.

The first of these is the definite written program requirements. I'm on slide 12. Section 1.401(a)(2) of the regulations provides that a plan must be a definite written program, and Section 1.401-1(b)(1) paragraphs (ii) and (iii) of the regulations provide that a plan must provide a definite, predetermined formula for allocating contributions.

We read these requirements as meaning that a reshuffling provision must provide for some methodology for how the reshuffling provision will work. So the provision must have language that directs the plan administrator as to the number of shares or amount of cash to transfer in or out of plan accounts. It must also provide the administrator or trustee with a methodology for determining which participants will transfer assets. And it must state the manner in which the transfers will be effectuated, such as the date of valuation. We're not looking for a precise formula here that calculates a specific number of shares or an exact dollar amount, but we are looking for some means or method for determining the accounts from which assets will be transferred and the amount of assets. As far as what language would exactly meet these requirements, those decisions would be made by our determinations branch.

As an example, we have on our Web site sample language for Section 409(p) transfers. This language is in the context of transfers to a non-ESOP portion of a plan, so it's a different context. For this sample language, it's in the context of transferring assets out of a participant's account into a non-ESOP portion of the plan in order to prevent the occurrence of a non-allocation year under section 409(p). It's a different context, but it might be useful to draw upon in terms of drafting reshuffling provisions that would meet the definite written program requirements.

For instance, in determining the amount of shares to be transferred, the sample language states the amount transferred under this section shall be the amount that the administrator determines to be the minimum amount that is necessary to ensure that a non-allocation year does not occur. The sample language also includes a method for determining which participants will transfer shares, which again is a different context than reshuffling provisions, this is in the context of avoiding a 409(p) violation, but it might be helpful as an example. You can find this on our Web site if you go to IRS.gov and search for sample ESOP language. It should pull up a page titled "sample language for Section 409(p) transfers."

The next category is benefits, rights, and features testing on slide 14. Section 1.401(a)(4)-4 of the regulations provides that benefits, rights, and features available to any employee under the plan must be provided in a manner that does not discriminate in favor of highly compensated employees. The right to a particular form of investment, such as employer securities, is specifically listed as a right that qualifies as a benefit, right, or feature under Section 1.401(a)(4)-4.

In order to ensure that a right is provided in a manner that is non-discriminatory, it must meet two requirements: the current availability requirement and the effective availability requirement. The current availability requirement states that a right under the plan meets the current availability requirement if the group of employees to whom the right is currently available satisfies Code Section 410(b). Code Section 410(b) provides the minimum coverage requirements, and it gives the rules for what percentage of employees who are non-highly compensated would need to have the benefit, right, or feature available to them in order to pass the test. Whether a right is currently available is based on the current facts and circumstances with respect to the employee.

The effective availability requirement states that the group of employees to whom the right is effectively available must not substantially favor highly compensated employees. This is an operational requirement, so it's not something that we're looking at in terms of plan language. The plan sponsor would need to ensure that the plan was meeting both requirements. But in terms of plan language, what we're really looking at is the current availability requirement.

On side 17, slide 17 notes that this is not really a concern for rebalancing provisions because in rebalancing provisions, all participants are treated the same. However, keep in mind that even with a rebalancing provision, although it might not be an issue in terms of the plan language as far as meeting the current availability requirement, you would need to make sure that, in operation, the provision was still meeting the benefits, rights, and features testing requirement.

When considering whether a right in your plan meets the current availability requirement, that is that it's available in a nondiscriminatory manner, you need to test all forms of investment, so not only the receipt of employer securities under the plan, but if for example you're reshuffling provision involves exchanging employer securities for cash, you would also need to test the receipt of cash as a right that needs to be available to

employees in a nondiscriminatory manner. The regulations also state that in determining whether a different type of employer security is to be considered a different form of investment that needs to be tested separately, you should take into account differences in conversion, dividend, voting, liquidation preferences, and other rights conferred under the security.

The second bullet on slide 17, what that's referring to is the benefits, rights, and features regulations provide that terminated employees are tested separately from active employees in determining whether a right is available in nondiscriminatory manner. So a plan that provides for the assets of terminated employees to be segregated from those of active employees does not necessarily have a discrimination problem because you'd be testing those groups separately under the regulations.

One question that we received related to this issue is whether a plan could provide that the trustee may exchange the stock of terminated employees for cash. Our concern with using the word "may" is that it might not meet the definite written program requirement, but the provision could be written so that whether or not the trustee carries out the exchange is based on the availability of assets. And the plan sponsor would also want to ensure that all of the terminated employees are treated the same in order to meet the benefits, rights, and features requirements.

Turning to diversification rights on slide 18, Code Section 401(a)(28)(B) provides that ESOPs must allow participants to direct the investment of at least 25% of their account each year. In the case of the last election year, 50%. As Robert mentioned, 401(a)(28)(B) is an area where we don't have a lot of guidance out at this time. It's definitely an area that we will be looking at if we do decide to go forward with regulations. But our interpretation at this time of this section is that participants who have transferred shares pursuant to 401(a)(28)(B) have a right not to have those shares mandatorily transferred back. So a reshuffling or rebalancing provision cannot cause shares that have been diversified by a participant under 401(a)(28)(B) to be mandatorily returned to that participant's account. If a plan is meeting the 401(a)(28)(B) requirements by distributing shares, there shouldn't be an ongoing problem with satisfying that section.

The next topic is ESOP asset segregation provisions. I think Robert is going to make a few comments here.

R. Gertner: Sure. Perhaps one of the more interesting parts of our response to the determinations branch had to do with the asset segregation for terminated employees. For those who do have access to, I guess it's number five, Clare, excuse me, number four, would see that we do talk about Revenue Ruling 96-47, which in situations where there is an immediate distribution or, if the distribution is not taken, then the amounts are to be placed in some sort of fund or a cash account without any of the investment elections provided for under the plan, this would be considered a substantial detriment to the participant, and basically the plan would have to provide for investment election options for the participant.

We did discuss this ESOP asset segregation in terms of this revenue ruling. We're very much aware that in many cases there's no immediate distribution. Participants are in the five-year deferral period, so we'd like to think there is some linkage there, but it's not a very tight linkage between the two. But we certainly thought it was the right policy call to request plan provisions that would preserve sufficient investment options to those individuals who have terminated employment. I guess the idea is that if investment options were in the plan, that indeed they must – those investment options need to be retained for those employees who have terminated.

We also, in this response, mentioned a fund or two, for example, lifecycle fund. We certainly don't anticipate named investments to be in the plan language. Basically, we were thinking more along the lines of the language defined in 401(a)(28)(B) when it describes investment options. Basically, we also asked determinations grants to come back to us with regard to any issues that this might raise. Clare?

C. Diefenbach: I'm going to end by discussing a couple of examples of plan language. Before I get into the examples, I want to clarify because we had a couple of questions in our earlier program this morning that these examples I'm going to be discussing, this is not language that we are promoting or suggesting. These are simply excerpts from plans that our determinations branch sent to us in connection with their request for technical assistance just to ask our opinion about the language.

So example one on slide 20 states that "the trustee may debit a participant's company stock sub-account with one type of employer securities provided the trustee credits such participant's company stock sub-account with another type of employer securities equal in fair market value, as determined by the independent appraiser as of such date. The trustee may debit a participant's company stock sub-account provided the trustee credits such participant's other investment sub-account on the date of such debit with assets equal to the fair market value of the employer securities debited, as determined by the independent appraiser of such date." Our response to this first example was that the language fails to satisfy the definite written program requirements because it allows the trustee complete discretion over which participants' accounts will transfer assets and the amount of assets transferred, so we'd be looking for some more methodology here.

The second example on slide 21 and 22 states: "Required divestiture for participants who have attained the age of 60. The trustee shall transfer from a participant's account the employer stock in such participant's account in accordance with the following schedule." At age 60, it's one-eighth of the employer stock; 61, one-seventh; and so on increasing until the participant reaches age 67 when it's 100% of his or her stock.

The plan language goes on to state "the transfer of the stock in the participant's account shall be made internally within the plan or sold by the plan. The consideration to the participant's account shall be the fair market value of the stock as of the date of such transfer. Once the transfers take place, the participant shall be entitled to direct the investment of the participant's non-stock account in accordance with the provisions of section 9.15."

Now in this example, unlike the first, the plan provision does give a methodology to the trustee for determining which participants will transfer shares and as well as determining the amount of shares to be transferred. It does – we do, however, believe that it needs a method for determining – for the trustee to determine which participants, if any, will receive the shares. For example, it could be pro rata based on the amount of employer securities in the account of each participant under the age of 60.

If there will be mandatory transfers of employer stock into the accounts of other participants, the provision would also need to preclude shares diversified under 401(a)(28)(B) from being mandatorily transferred back. And as far as the benefits, rights, and features testing, the language here does not raise any current availability concerns. However, the plan sponsor would need to ensure that operationally the provision is meeting the benefits, rights, and features requirement.

That concludes the main part of our presentation.